DOCUMENT RESUME

ED 260 496 EA 017 939

AUTHOR	Miller, Ned A.
TITLE	Nonsalary Compensation for Employees of Independent Schools.
INSTITUTION	National Association of Independent Schools, Boston, Mass.
REPORT NO	ISBN-0-934338-55-8
PUB DATE	84
NOTE	44p.
AVAILABLE FROM	Publication Sales, National Association of Independent Schools, 18 Tremont Street, Boston, MA 02108.
PUB TYPE	Guides - Non-Classroom Use (055)
EDRS PRICE	MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS	*Compensation (Remuneration); Elementary Secondary Education; *Fringe Benefits; Health Insurance; Insurance; *Private Schools; Retirement Benefits; *School Personnel; *Teacher Employment Benefits
IDENTIFIERS	*Deficit Reduction Act 1984

ABSTRACT

A guide, intended to help independent schools attract and retain competent people through appropriate compensation packages, provides the basis for a review of a school's current general benefits program. It also contains suggestions for improving compensation packages by offering a wider range of tax-favored nonsalary benefits without necessarily increasing the overall cost to the school. The first of four sections, "Capital Accumulation Plans," describes plans for pensions, tax-sheltered annuities, deferred compensation and continuation, and individual retirement accounts. "Financial Protection Plans" describes 10 plans that provide medical and dental, disability, and death coverage; prepaid group legal coverage; and financial counseling. The third section, "Indirect Pay Plans," describes plans that cover professional memberships, tuition payments, dining hall privileges, automobile leasing, housing, and sabbatical leaves. The final section, "Cafeteria Compensation Plans," refers to plans that allow employees, within legal limits, to design benefit programs that meet their own particular needs. Concluding the guide are summaries of cafeteria plans and of the Deficit Reduction Act of 1984 that resolved many issues that surrounded cafeteria plans. (MLF)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED260496

NONSALARY COMPENSATION FOR EMPLOYEES OF INDEPENDENT SCHOOLS

Ned A. Miller

U.S. DEPARTMENT OF EDUCATION
NATIONAL INSTITUTE OF EDUCATION
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

X This document has been reproduced as received from the person or organization originating it.

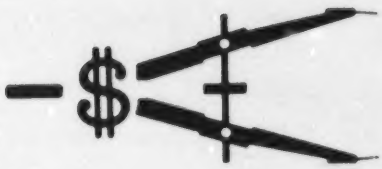
☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official NIE position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL IN MICROFICHE ONLY HAS BEEN GRANTED BY

B. McElroy

TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."



NATIONAL ASSOCIATION OF INDEPENDENT SCHOOLS

EA 017 939

Copyright © 1984 by the National Association of Independent Schools. All rights reserved. No part of this publication may be reproduced in any form without permission in writing from the publisher.

Printed in U.S.A.

ISBN 0-934338-55-8

Contents

Preface v

CAPITAL ACCUMULATION PLANS 1

1. Pension Plan - 1
2. Matching Thrift Plan - 4
3. Tax-Sheltered Annuity - 6
4. Deferred Compensation and Salary Continuation Plan - 8
5. Individual Retirement Account - 10

FINANCIAL PROTECTION PLANS 12

1. Health Insurance Plan - 12
2. Dental Plan - 14
3. Prescription Drug Plan - 15
4. Insured Medical Expense Reimbursement Plan - 16
5. Stop-Loss Health Plan - 18
6. Disability Income Plan - 20
7. Group Life Insurance Plan - 21
8. Travel Accident Insurance Plan - 23
9. Prepaid Group Legal Plan - 24
10. Financial Counseling - 26

INDIRECT PAY PLANS 28

1. Professional Memberships - 28
2. Tuition Payment Plan - 29
3. Dining Hall Privileges - 30
4. Automobile Leasing Plan - 31
5. Housing - 32
6. Sabbatical Leave - 34

CAFETERIA COMPENSATION PLANS 36

Preface

For several years, the NAIS board of directors has been concerned about the compensation of those who work in independent schools, particularly teachers. It is no secret that the average salary of independent school teachers is considerably lower than that of their public school counterparts. Since the basis of our schools is teachers and administrators, and since their effectiveness depends in large part on their working conditions and the quality of their lives, the NAIS board of directors has commissioned this guide as an aid in improving the compensation offered to those who work in independent schools.

This guide can be useful in two principal ways. First, it can provide a quick review of the school's current general benefits program to identify possibilities for its employees that have not yet been recognized. Second, it contains suggestions for improving compensation packages by offering a wider range of tax-favored nonsalary benefits without necessarily increasing the overall cost to the school.

A variety of options for designing maximum employee compensation are presented. Various kinds of group insurance plans that cover all employees are now familiar, but other plans are also available that allow schools to provide benefits to individuals or to groups on a selective basis. This manual describes several such plans.

There are four sections, covering capital accumulation plans, financial protection plans, indirect pay plans, and cafeteria compensation programs. Each section contains the most useful plans for independent schools in that category, according to the following outline.

a. Description of the benefit plan
b. Type of employee entitled to benefit
c. Sources of further information
d. Considerations for the school
e. Considerations for the employee
f. Example of benefit in practice
g. Legalities and liabilities
h. Effect of termination of employee

The idea of using tax-favored benefits to improve compensation has been used by American businesses for some years to improve the quality of employees' lives. It seems only appropriate that these same opportunities be used by our schools; even though the approach is relatively new, we believe it to be well worth examining.

We offer this guide solely as a source of general ideas for schools to pursue with their own legal counsel, benefits counselors, and accountants, not as a definitive outline or to suggest any particular plan or arrangement. It has been developed by Ned A. Miller, CLU, of Albuquerque, New Mexico, who is an experienced benefits counselor to various businesses and several independent schools. Although we have asked Ropes & Gray, legal counsel of NAIS, to review

the text in an attempt to avoid technical inaccuracies, neither NAIS nor Ropes & Gray recommends any particular plan or arrangement described herein. Indeed, depending on the individual circumstances of each school, some plans or arrangements discussed here may not be desirable, or may not have the desired tax consequences.

The complexity of the legal requirements and tax consequences of these plans and arrangements cannot be covered in a document of this scope. In addition, tax laws change frequently; in fact, publication was delayed so as to include new directives from the Deficit Reduction Act of 1984. For these and all of the foregoing reasons, we strongly urge schools not to proceed with these new forms of compensation without exploring them fully with their own legal counsel.

We hope that this publication, especially in view of the anticipated teacher shortage, will serve as a tool to help independent schools attract and retain competent people through appropriate compensation packages.

John C. Esty, Jr.
President
National Association of Independent Schools

CAPITAL ACCUMULATION PLANS

Capital accumulation plans, aimed at producing income during retirement, are all long-term in nature. This section describes plans funded entirely by the school, by the employee, or by both.

A school may have several capital accumulation plans, which, because they are flexible, may be installed independently of one another. As organizations that generally qualify as nonprofit 501(c)(3) institutions, independent schools may offer their employees both "qualified" and "nonqualified" plans.

A qualified plan, such as a pension plan, requires formal approval by the Internal Revenue Service. The most prevalent form of nonqualified plan is a tax-sheltered annuity, which requires no contribution by the employer and thus is completely voluntary for the employee. A "qualified" program generally allows a tax-paying institution a current income tax deduction. A "nonqualified" program does not. (This is, of course, incidental information for independent schools, as nonprofit organizations.) Independent schools may offer either or both types of plans. A contribution formula for either a qualified or a nonqualified plan is based on income, length of service to the school, age, and other factors. This formula does govern the maximum amount of contribution allowed to either type of program, however. Both qualified and nonqualified plans are described here.

1. Pension Plan

a. Description of the benefit plan

A pension plan allows the school to set aside funds on behalf of an employee in a separate account or trust according to a formula approved by the Internal Revenue Service. One such formula, called a "defined contribution formula," determines a percentage--5 or 6 per cent, for example--of a person's salary to be set aside. Under this type of pension plan, employees do not know exactly how much retirement income to expect because of varying interest rates paid over their period of employment.

A second formula, called a "defined benefit formula," calls for the school to provide an annual benefit of a predetermined percentage, such as 20 or 30 per cent, of the employee's preretirement salary at age 65. Under this plan, the amount of the retirement benefit, but not the cost of providing it, is determined under a formula, because deposits are based on age, length of service, interest rates, and other variables.

A pension plan can be either a "qualified" or a "nonqualified" plan. The qualified plan is subject to more stringent requirements, such as nondiscrimination rules, but it offers more tax advantages to participants.

A nonqualified plan offers more flexibility because it allows different contributions on behalf of different groups of employees. Contributions under a nonqualified plan are made to annuity contracts or to custodial accounts investing in mutual fund shares--the same types of investments that are permitted for tax-sheltered annuities, described on pages 6 and 7, below.

b. Type of employee entitled to benefit

Generally, pension plans must be offered to all full-time employees who are at least 25 years of age and have one year of service. If the school is paying 100 per cent of the pension deposit--for example, 3 per cent of salary for all employees--then all eligible employees must participate in the plan. If the school is not making any contribution, then entrance into the plan by employees is, obviously, voluntary. "Full-time" generally refers to employees who work 1,000 hours or more per year. Schools may actually raise the length of service to three years or the minimum age to 30, but not both, if benefits are at all times fully vested.

It is possible for pension plans to cover only some categories of employees. If a plan is to be qualified, however, it must have participants representing all income levels in the school.

c. Sources of further information

Legal guidance is needed for drafting a pension plan document outlining the duties and responsibilities of all parties to the plan. A benefits counselor can design the plan in accordance with the school's financial program and the wishes of its trustees.

d. Considerations for the school

Assuming the school wishes to install a pension plan, its first consideration is whether to benefit certain employees or all employees. If the school chooses to benefit all employees equally by contributing 5 per cent of salary for everyone, a qualified plan is desirable. The school might, however, wish to provide more benefits for certain types of employees. In the case of long-time employees, for example, the formula could be geared to years of service plus 1/10 of 1 per cent of salary for each year of past employment. This can always be accomplished in a nonqualified plan; in a qualified plan, contributions may not discriminate in favor of higher-paid employees. Whether discrimination is present depends on the facts of each situation. In the present example, there is no discrimination if the longer-term employees also include lower-salaried employees.

A school may allow an employee to retain the right to receive benefits based on 100 per cent of the school's contribution upon termination of employment regardless of age or years of service. In other words, the benefits are fully vested and thus are nonforfeitable by the employee at all times. As a matter of law, nonqualified pension plans must provide nonforfeitable benefits. Qualified plans, on the other hand, typically require a certain number of years of service before benefits become nonforfeitable.

Many schools have chosen TIAA/CREF--the Teachers' Insurance and Annuity Association and the College Retirement Equities Fund, an allied funding organization that invests mainly in equity products on behalf of teachers and administrators in schools, colleges, and certain other organizations. Other insurance companies also offer pension and annuity programs.

e. Considerations for the employee

If the plan is mandatory and requires no contribution from the employee, there is nothing to consider, because the school's pension committee predetermines all procedures governing vesting and other rights.

f. Example of benefit in practice

The school has 30 employees, all of whom are near the age of 40 and earn an annual salary of approximately $20,000. Ten of them have been at the school 10 years longer than the others. The head of the school feels that the school's pension plan should reward these 10 employees. The board agrees.

A plan is drawn up assigning one point per year for all years of service, past and future. The 10 employees having the greatest seniority therefore each receive 35 points, reflecting service from age 30 to age 65, and the remaining 20 employees each receive 25 points (reflecting service from age 40 to age 65.

Because the board has decided to spend 5 per cent of the total payroll of $600,000 on pensions, $30,000 is divided according to the accumulated points, with each of the 10 senior employees having $1,235 contributed to their individual pension accounts, and the other 20 having $883 contributed.

"Seniority" here refers to length of service, not ranking based on salary. If the plan is to be qualified, the contribution formula must not favor higher-paid employees in any year (reckoned as a percentage of current pay for the year). Generally, it is safer to use a nonqualified plan in a case such as this, assuming that the school is willing to give all employees a fully vested interest in contributions made for their benefit.

g. Legalities and liabilities

After initiating a pension plan, the school may cancel it owing to a "business necessity," such as reduced income because of decreased enrollment. Individual participants would, however, be vested--or have ownership in the school's contribution--regardless of how many they had actually been in the plan. The school, under the Employee Retirement and Income Security Act of 1974 (ERISA), is responsible and liable for plan sponsorship, which includes reporting and disclosure obligations, fiduciary responsibilities, and an obligation to make required contributions to the plan.

h. Effect of termination of employee

The pension plan document specifies the percentage of the school's contributions, or the percentage of the plan benefit, to which the employee is entitled

upon termination of employment before retirement. If, for example, the plan at School A indicates a monthly retirement benefit of $400 per month at age 65, the terminating employee may after 10 years of service be entitled to only 30 per cent of the benefit. That employee would have $120 per month of retirement income from School A even though he or she was employed at School B. Many schools offer terminating employees 10 per cent of their benefit for each year of employment as an incentive to remain with the school.

2. Matching Thrift Plan

a. Description of the benefit plan

A matching thrift plan allows the school to match employee contributions through a predetermined formula based on salary. The employee must contribute before the school makes its contribution. Many schools match contributions at levels ranging from 2 to 5 per cent of salary. It is up to the employee to decide whether or not to participate.

b. Type of employee entitled to benefit

Like pension plans, matching thrift plans must be offered to all full-time employees 25 years of age or over having at least one year of service. "Full-time employees" generally means employees who work 1,000 hours or more per year. The school may raise the length of service to three years or the minimum age to 30, but not both, if benefits are at all times fully "vested," or nonforfeitable. The school is free to devise different contribution formulas for different types of employees.

Like a pension plan, a matching thrift plan may be qualified or unqualified. A qualified thrift plan must cover all employees, or a cross section of all income levels, and must not result in disproportionately greater school contributions in any year, as a percentage of pay, for higher-paid employees than for lower-paid employees. If it does not, discrimination could be claimed. A nonqualified thrift plan may cover any group of employees. It offers more flexibility of contribution levels, even though contributions must be fully vested and nonforfeitable at all times.

The following are examples of a school's contributions to a nonqualified matching thrift plan based on length of service, with the employee in each case contributing 5 per cent of salary in addition to the school's contribution: (1) More than 10 years of service: 10 per cent of salary; (2) five to 10 years: 7 1/2 per cent of salary; (3) one to five years of service: 5 per cent of salary; (4) less than one year of service: 2 1/2 per cent of salary.

c. Sources of further information

An actuary should design the matching thrift plan, and an attorney should draft the plan documents. It is also possible to obtain from an insurance company or mutual fund a plan document that covers the basic legal points. The school's

attorney should review such a document to make sure that it is consistent with the intent of the school and the law.

d. Considerations for the school

The school must consider which employees it wants to benefit. If it wishes to help all employees without regard to length of service, it could contribute a straight percentage of salary. If it wants to favor long-term employees, varying percentages may be used, such as those outlined in paragraph b, above.

e. Considerations for the employee

All employees must consider their ability to contribute and the vesting schedule offered by the school, which states what percentage of the school's contribution is available upon termination of employment, depending on years of service.

f. Example of benefit in practice

An employee 55 years old earns $25,000 a year as head of the middle school, where he has worked for 20 years. He petitions the head to ask the board of trustees to institute a matching thrift plan for the school's employees, most of whom are young and have little discretionary income.

The board wishes to recognize long-term service. It offers a plan for matching contributions in increasing percentages, according to length of service. A maximum matching contribution of 12 1/2 per cent could be offered to employees having more than 20 years of service who first contribute 5 per cent of their salaries. The school requires employees to participate in the plan for four years before their benefits may be vested. This requirement enables the school to recover most of its contributions to younger employees who leave before that time.

Under the new plan, an employee earning $25,000 a year with over 20 years of service--in this case, the head of the middle school--contributes $1,250 a year (5 per cent), and the school contributes $3,125 a year (12 1/2 per cent). After 10 years, at 8 per cent interest (in this example), the total accumulation is $68,446. The school in this situation should take great care to make sure that the middle school head is not the only person in the "20 years of service" category and that higher- and lower-paid employees benefit from roughly comparable contributions, as a percentage of pay, by the school each year. Otherwise, the plan could become nonqualified because of discrimination. If the plan loses its qualified status, contributions made by the school on behalf of the employee are considered currently taxable income to the employee. This should be avoided at all costs.

The school could, on the other hand, adopt a nonqualified matching thrift plan, which permits such discrimination, but its contributions would have to be vested immediately rather than after four years of participation by employees.

g. Legalities and liabilities

After initiating a matching thrift plan, a school may cancel it because of "business necessity," which could, for example, result from reduced tuition income owing to decreased enrollment. Individual participants will, however, still be vested--have ownership in the school's contribution--regardless of the number of years they had actually been in the plan. In such a case, the school has general ERISA (Employee Retirement and Income Security Act of 1974) responsibilities and liabilities of plan sponsorship, including reporting and disclosure obligations, fiduciary responsibilities, and an obligation to make required contributions to the plan.

h. Effect of termination of employee

The plan document should indicate the amount of time required for an employee to become vested. Employees terminating before this time are entitled only to their own contributions, plus interest. If employees leave after becoming vested, they may receive the total amount of their contributions as well as the school's contributions. The school has no further obligation to continue the contributions.

3. Tax-Sheltered Annuity

a. Description of the benefit plan

A tax-sheltered annuity is available for tax-exempt 501(c)(3) schools. Because this type of program is voluntary and requires no school contribution, it is a nonqualified program. Under a tax-sheltered annuity, an employee may elect to reduce his or her gross taxable income up to certain limits allowed by the Internal Revenue Service. The reduced amount is paid by the school directly into a TIAA annity or into an annuity program of another insurance company, where it can accumulate until the employee wishes to withdraw it, at retirement or before. Tax-sheltered contributions may also be made for employees to certain custodial accounts, held by banks or other approved persons, to be invested in mutual fund stock.

Unlike an individual retirement account (IRA), most tax-sheltered annuity contracts do not impose a penalty for early withdrawal. The employee does, however, have to pay income tax when the money is withdrawn. Money may not be withdrawn from mutual fund custodial accounts before age 59 1/2, except in cases of hardship, total disability, termination of employment, or death.

b. Type of employee entitled to benefit

Any employee, including a part-time employee, may receive this benefit.

c. Sources of further information

A benefits counselor, TIAA/CREF representative, or mutual fund representative may be consulted.

d. Considerations for the school

The money placed in a tax-sheltered annuity or custodial account belongs to the employee, not to the school. The school's main responsibility is bookkeeping and timely payment to the financial institutions involved. In some cases, the annuity may be a "plan" as defined under the Employee Retirement Income and Security Act of 1974 (ERISA), with corresponding ERISA duties and liabilities for the school.

e. Considerations for the employee

Employees should recognize that this type of deduction is intended as an intermediate- to long-term savings plan. They should also recognize the immediate savings realized in reduced taxes. When they recover benefits, before or after retirement, ordinary income taxes are imposed.

f. Example of benefit in practice

A new, single teacher is responsible for her retirement, because the school does not have a pension plan. She decides that she can live on less than her salary of $15,000 and signs a salary reduction agreement with the school to receive $12,500 instead. At her direction, the school applies to an insurance company for an annuity having an annual premium of $2,500. Given her present age of 40 and an interest rate of 8 per cent, she can accumulate $197,385 by the time she reaches age 65. She could receive this money in one lump sum, which would be taxable immediately. Or she might elect to take a lifetime monthly payment, in which case she would be taxed only on the amount she received each month.

g. Legalities and liabilities

If this is a "plan" as defined under ERISA, the school has reporting and disclosure obligations as well as other fiduciary responsibilities and liabilities. Whether a plan comes under ERISA regulations depends on the degree of involvement of the school and the extent to which the school limits tax-sheltered investment choices.

h. Effect of termination of employee

The school suspends payments upon an employee's termination. The employee may leave the amount then in the annuity to accumulate at interest with the insurance company. The employee may continue the plan at another school, if the school sponsors the same insurance company, or simply withdraw the amount invested and pay the taxes due. The employee could also start a new plan at the new place of employment, assuming it was a nonprofit institution.

4. Deferred Compensation and Salary Continuation Plan

a. Description of the benefit plan

A deferred compensation program reallocates income by deferring current salary to retirement years. A salary continuation plan provides for employees' salaries to abe paid to their heirs after death.

Because deferred compensation and salary continuation are frequently merged into a single plan, they are treated jointly here. A portion of the employee's salary continues to be paid to the employee after retirement in addition to whatever pension plan payments are made. A death benefit is usually paid to the employee's spouse and children if death occurs before retirement and before age 65.

Note. Deferred compensation plans, which are nonqualified, have no relation to tax-sheltered annuity or qualified pension and thrift plans. Many schools use deferred compensation programs when maximum limitations on pension and tax-sheltered annuity contributions have been reached.

b. Type of employee entitled to benefit

This benefit is intended for an employee who is more concerned about future income than current income. The school might limit eligibility to the head, long-tenured department heads, or others in management. Many employees elect to defer raises and ask the school to set up a separate fund, usually through an insurance company, bank, mutual fund, or other agency. Deferred compensation programs should be limited to certain selected or highly paid employees.

c. Sources of further information

An attorney should be asked to design and draft a deferred compensation agreement in order to avoid complications with the Internal Revenue Service. Representatives of TIAA/CREF or other benefits counselors may be asked to design the formula for deferred compensation.

d. Considerations for the school

The school should consider a deferred compensation plan if it has "key employees" it wishes to benefit. Payment to the deferred compensation fund would be in lieu of a salary increase and thus be of no additional cost to the school. The school is the owner and beneficiary of the investment account and the insurance policy. The employee or spouse receives the stipulated payments either before or after death, by contract with the school.

e. Considerations for the employee

Employees who select this plan should recognize that current income is being deferred for its reallocation to themselves at retirement or to heirs after death.

All payments expected to be made by the school to the employee--or spouse--are made by contract with the school, not with the investment or insurance company. The assets of the fund are therefore assets of the school and thus are subject to the claims of the school's creditors. These payments are included in FICA wages when earned, if vested. The employee should discuss such a plan with a personal financial adviser.

f. Example of benefit in practice

Assume that the head of the school earns a salary of $35,000. When combined with her husband's salary, their total income is subject to a 50 per cent marginal income tax. The school offers the head a $10,000 raise, but she has concerns that take priority over immediate financial gain. She wants her husband to receive part of her salary if she dies. She also recognizes that the school is pressed to meet increasing expenses. Finally, she knows she would net only $5,000 of the raise after taxes.

The head and the school work out a salary continuation plan that satisfies both their needs. First, the school buys a life insurance policy for $175,000 and pays $5,000 a year in premiums. The school is owner and beneficiary of the policy. Upon the head's premature death, it would pay a previously determined sum to the head's husband. The school invests another $5,000 a year elsewhere, which, at 8 per cent interest, is expected to increase to $247,115 by the time the head retires in 20 years. The total annual investment by the school is exactly the same $10,000 it had budgeted.

At her retirement, the school will pay the head the income from the interest on the $247,115 for the rest of her life (a minimum of 15 years). At her death, her husband, or other beneficiary if her husband dies first, receives the $247,115 and the school receives the proceeds of her life insurance policy--$175,000. If the head had accepted her raise, the school's outlay of $10,000 would have been the same, but it would not have had the opportunity to recover part of its investment.

g. Legalities and liabilities

The school has a contractual liability to pay the income deferred at age 65 and the death benefit prior to retirement to the spouse. The cash liability would appear to be little if anything, since the death benefit would be fully insured by the life insurance policy, and the retirement sum would likewise be put into in a conservative investment.

h. Effect of termination of employee

The deferred compensation and salary continuation agreement may contain a clause saying that a termination payment may be made to the terminated employee. This amount should not be tied directly to the insurance policy or the investment account, even though there will probably be enough money in either one to pay the termination settlement. The Internal Revenue Service might apply the doctrine of "constructive receipt" and levy current income tax on the departing employee. With proper planning, school and employee can avoid this problem.

5. Individual Retirement Account (IRA)

a. Description of the benefit plan

An individual retirement account (IRA) allows an employee to invest 100 per cent of salary up to $2,000 a year ($2,250 in the case of an employee and a nonworking spouse) in various investment vehicles. Unlike personal savings accounts, the IRA accumulates on behalf of the participant free of federal income tax until distributions, which must begin before age 70 1/2, are made.

b. Type of employee entitled to benefit

Any employee, including a part-time employee, is eligible.

c. Sources of further information

Companies offering investments of various kinds each have their own forms for simplified filing with the Internal Revenue Service.

d. Considerations for the school

The school does not make or match any contributions on behalf of the employee. The employee may make contributions directly to the funding institution or ask the school to make them through payroll deductions. The school need not do this, however.

e. Considerations for the employee

Employees may enroll in an IRA even though they are also enrolled in the school's pension plan or tax-sheltered annuity program. (Laws effective January 1, 1982, allow participants in other programs to be eligible for IRA programs.) A penalty of 10 per cent--in addition to any income tax--applies to withdrawals before age 59 1/2. Employees should recognize that IRA programs are not short-term investments. A younger employee would be best served by continuing IRA contributions with little or no interruption or at least by leaving the existing money intact to earn interest until retirement age.

f. Example of benefit in practice

The school's librarian is enrolled in the school's pension plan and is contributing the maximum amount to his tax-sheltered annuity. He would like to save more. He asks the school to place $2,000 of his salary in an IRA through payroll deductions. The money is invested separately in an IRA annuity account bearing the librarian's own identification number. It may also be invested in any one of another funding vehicles, such as bonds, stocks, or certificates of deposit. The librarian may adjust his taxable income by $2,000 on his personal federal income tax return. If he is in the 30 per cent federal income tax bracket, his IRA would enable him to save $600 in income tax.

When the librarian receives income from his IRA after age 59 1/2, he pays income tax on the amounts received. He may also withdraw the total savings in a lump sum taxable at that time.

g. Legalities and liabilities

The school, not a party to the contract, simply serves as a bookkeeper in collecting the income and making timely payments to the funding company.

Employees may invest money on their own and still take the income tax deduction. The school should make sure that its payroll deduction responsibilities are set up in such a way as to avoid being subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting and fiduciary requirements.

h. Effect of termination of employee

None.

FINANCIAL PROTECTION PLANS

This chapter describes 10 family protection plans that provide medical and dental, disability, and death coverage; prepaid group legal coverage; and financial counseling. Some of the programs require a majority of the school's employees to be covered, while others can protect only one employee. These plans offer only protection; no asset is being created.

1. Health Insurance Plan

a. Description of the benefit plan

A health insurance program helps to pay health care expenses for employees and their families. After the employee pays the deductible amount (usually $100 or $250), the basic group health insurance plan traditionally reimburses an employee for 80 to 90 per cent of total eligible health care expenses. Some kinds of health care, such as cosmetic surgery, do not qualify for reimbursement. Others, such as psychiatric and orthodontic care, do not qualify for reimbursement over a certain limit.

b. Type of employee entitled to benefit

Approximately 80 per cent of all employees must join a plan because insurance companies oppose "adverse selection"--the possibility that only those who are in poor health will select such a plan, not the healthy majority.

c. Sources of further information

A benefits counselor may be asked to design the program.

d. Considerations for the school

In the case of health insurance, the lower the deductible--$50 or $100--the higher the premium, and the higher the deductible--$500 or $1,000--the lower the premium. The deductible is the dollar amount the employee must pay before the insurance company starts to pay its contractual percentage of a medical claim.

The school should consider the effects of a community-rated plan as compared with an age-rated plan. Blue Cross/Blue Shield, for example, offers a community rate structure. Each organization in a given Blue Cross district pays the same insurance premium regardless of the ages of those insured. The rates Blue Cross determines are averaged for a specific area of a state or community; hence the name "community-rated plan."

An age-rated plan, offered by most insurance companies, is based on the age of

specific employees of the organization entering the plan. The insurance company then averages the rates for that organization.

Blue Cross sets a single community-wide rate for all persons entering a plan. This rate is usually equal to an insurance company's premium rate for persons aged 45. It would seem, therefore, that schools whose employees' average age is over 45 would be better off with Blue Cross, and that schools whose employees' average age is under 45 would find it less expensive to be insured by a program other than Blue Cross.

Another consideration is the payment of premiums by the school on behalf of employees. Many schools pay the total premium for employees but none for their dependents.

e. Considerations for the employee

An employee who has a working spouse who is also entitled to health care coverage should look at both policies to determine the cost of dependent coverage under both policies before electing a plan. For example, a teacher is entitled to free medical coverage for herself but she must pay $80 a month to include her husband and children. Her husband works for the town and is also entitled to free individual coverage but pays only $60 to include the family. In this situation, assuming that the terms of both health plans are identical, the teacher should not include dependents in her coverage but suggest that her husband include her and the children in his policy.

f. Example of benefit in practice

The school adopts a health insurance plan after looking at the rates of Blue Cross and several insurance companies. The school wishes to reduce its expenditure by designing a plan having a two-tier deductible, with the higher deductible for higher-paid employees, on the assumption that they can afford a higher deductible, and the lower deductible for those who are paid less. A young teacher incurs a claim of $2,100. His deductible of $100 leaves $2,000 in unpaid bills. The insurance company covers 80 per cent of $2,000, or $1,600, which leaves $500 ($400 plus the $100 deductible) for the teacher to pay himself. The teacher's department head incurs the same expense--$2,100--but she must pay the first $200. This leaves $1,900, of which the insurance company pays $1,520 (80 per cent). The department head's out-of-pocket cost is therefore $580 ($2,100 less $1,520).

g. Legalities and liabilities

This plan is subject to ERISA (Employee Retirement Income Security Act of 1974) reporting, disclosure, and fiduciary responsibilities. The school should tell employees what is covered and, more important, what is not covered in the health insurance contract. The school must tell employees what options for continuing coverage are open to them upon termination of employment. Otherwise, employees encountering new medical bills could claim that they had not been told about these options, which in turn could make the school liable for former employees' medical bills.

h. Effect of termination of employee

The school notifies the insurance company that the employee is no longer covered and tells the employee what options for converting the policy from group to individual coverage are available.

2. Dental Plan

a. Description of the benefit plan

A dental plan helps to pay for the costs of dental care, which are divided into three areas: primary care, such as cleaning, X-rays, and fillings, usually paid at 80 per cent of charges; periodontic work, crowns, and gold fillings, usually reimbursed at 50 per cent of charges; and orthodontic work, also usually reimbursed at 50 per cent of charges.

b. Type of employee entitled to benefit

Dental insurance is usually offered in the form of a group policy. Ordinarily, 70-80 per cent of eligible employees must participate in the plan.

c. Sources of further information

A benefits counselor may be asked to design the program.

d. Considerations for the school

The school should first consider whether or not it wants a broad-based plan, one that includes 70-80 per cent of employees. If the school wants to provide a program for only a few employees, it may decide to adopt an insured medical expense reimbursement plan (see section 4, pages 16-18, below). Another consideration is inclusion of orthodontic care, which is usually sold separately. Despite its added cost, this benefit is attractive to families with children who have crooked teeth.

e. Considerations for the employee

If it is up to the employee to pay for including dependents in the dental plan, that cost should be measured against the cost of uninsured dental care for the family.

f. Example of benefit in practice

A teacher at the school, which has a dental program, finds he needs periodontal care. He gets a form from the school's business office on which the periodontist lists projected services and costs. The form must be sent to the insurance

company before work may begin. If the proposed work and fees are in line with usual costs, they are accepted, and the dentist may begin treatment. A claim is subsequently filled out and paid.

g. Legalities and liabilities

This plan is subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting, disclosure, and fiduciary responsibilities. The school should tell employees what is covered and, more important, what is not covered in the dental plan contract. The school must tell employees what options for continued coverage, if any, are open to them upon termination of employment. Otherwise, employees encountering new dental bills could claim that they had not been told about these, which in turn could make the school liable for paying the dental bills of former employees.

h. Effect of termination of employee

Dental plan coverage is canceled when an employee terminates. No conversion privileges from group to individual coverage are available.

3. Prescription Drug Plan

a. Description of the benefit plan

A prescription drug program is separate from the school's health plan. It pays 100 per cent of drug bills after a deductible of one or two dollars.

b. Type of employee entitled to benefit

Eighty per cent of eligible employees must be included. Because this may be a separate plan, different eligibility formulas may be arranged. The basic health plan described previously may be open to "all employees over age 21 with one month of service." A prescription drug program could be designed for the more permanent employee and have an eligibility formula of "age 25 with two years of service." Basically, depending on their age and length of service, different employees may be eligible for one plan but not another.

c. Sources of further information

A benefits counselor may be asked to design the plan.

d. Considerations for the school

Prescription drug coverage is a new type of benefit. Prescription drug care is covered under the school's health plan, but the employee must satisfy the $100 deductible before receiving the benefit. Under the new plan, prescription drugs

are covered after a deductible of only one or two dollars per employee. This could be a very attractive, inexpensive benefit from the school to provide for its longer-term employees.

e. Considerations for the employee

If 100 per cent of the coverage is paid by the school, the employee has nothing to consider. If the employee is required to pay for dependent coverage, the cost of the premium should be measured against against what prescription drugs would cost the family without this coverage.

f. Example of benefit in practice

The head of the school petitions the board of trustees to set up a prescription drug plan with a $1 deductible. Under this program, each employee is issued a prescription card, to be presented, with prescriptions, to a participating pharmacy. The pharmacist collects $1 from the employee, fills the prescription, and uses the employee's prescription card to complete a form that is sent to the insurance company. The insurance company then pays the pharmacist the difference between the $1 paid by the employee and the cost of the medication.

g. Legalities and liabilities

The school is responsible for timely payment of the premium to the insurance company and for complying with reporting, disclosure, and fiduciary obligations under ERISA (Employee Retirement Income and Security Act of 1974).

h. Effect of termination of employee

The school must recover the employee's prescription card when the employee leaves, at which time coverage stops. This benefit may not be converted to individual coverage.

4. Insured Medical Expense Reimbursement Plan

a. Description of the benefit plan

This separate insurance plan provides a special benefit for employees who have substantial medical expenses that are not reimbursable or are only partly reimbursed under the regular health insurance program, such as cosmetic surgery, psychiatric care, or expensive dental care.

b. Type of employee entitled to benefit

One or several employees may be selected to receive this benefit, provided the

plan is insured. Following the Revenue Act of 1978, it is no longer possible to provide a self-insured medical expense reimbursement plan for a higher-paid group of employees without causing them to be subject to tax on their reimbursements. A self-insured plan is one where the school in effect becomes the "insurance company." The school simply states that it will provide medical coverage up to, say, $2,000 or $3,000 for a certain group of people at the school. Any of these people incurring an eligible medical expense would submit the bill to the school, not to an insurance company, and the school would reimburse the employee directly.

"Shifting of risk" is required for a plan to be called an insured plan. Some insurance policies do not have a "shifting of risk" provision; others do. It is important for the school to determine the policy's adequacy before deciding whether to enter into a contract with a given company.

c. Sources of further information

Legal guidance is required for drafting a resolution for the board of trustees.

d. Considerations for the school

The school should not adopt a plan unless one or more employees have substantial unreimbursed medical expenses. There are no disadvantages to the school in offering this benefit other than its small administrative cost--in addition, of course, to the required insurance premiums.

e. Considerations for the employee

The insurance company reimburses the employee for expenses not otherwise covered by the school's existing group health insurance plan. These expenses could include those mentioned above in paragraph a as well as the deductible and co-insurance amounts referred to above in part 1 (pages 12-14), dealing with health insurance plans. "Co-insurance" indicates that two parties--the insurance company and the employee--share payment of an eligible bill. If the insurance company pays 80 to 90 per cent of an eligible claim, the employee pays the remaining 20 to 10 per cent of the bill. The employee incurs no cost or tax liability if the plan is an insured one. It is permissible for the school to sponsor both a basic group health policy and an insured medical expense reimbursement plan.

Prior to the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), an employee could not deduct medical expenses unless they exceeded 3 per cent of adjusted gross income. As of January 1, 1984, that figure was increased to 5 per cent.

f. Example of benefit in practice

The school learns that several employees in the senior school are having high unreimbursed medical expenses for psychiatric and dental treatment. The school's current health plan covers out-of-hospital psychiatric care, as well as

dental care, up to $1,000. The school subsequently enters into an insured medical expense reimbursement plan with an insurance company for this specific category of employees. When the school receives one of these employees' claims --$10,000, for example--it forwards the claim to the insurance company with the premium due; unlike more familiar insurance plans that require a set monthly premium, some insured medical reimbursement plans have premiums that vary depending on the claims and are paid at the time the claim occurs. In such a case, the school pays the premium directly to the insurance company. After administering the claim, the insurance company sends the payment directly to the employee.

g. Legalities and liabilities

An insured medical expense reimbursement plan is normally subject to the reporting, disclosure, and fiduciary obligations of ERISA (Employee Retirement Income and Security Act of 1974).

h. Effect of termination of employment

When an employee terminates, the policy is canceled and the school has no further obligations to pay premiums.

5. Stop-Loss Health Plan

a. Description of the benefit plan

This is a health plan in which the school's premium payments are put into a separate school trust fund. The trustees hire an independent claims administrator. An insurance company is hired to assume the risk. Both the administrator's fee and the insurance premiums are paid from the trust fund. When a predetermined amount is reached, the insurance company steps in to reduce any extremely high loss; hence the name "stop loss." Benefits and policy details are the same as under a regular fully insured medical plan.

b. Type of employee entitled to benefit

All employees must receive this benefit.

c. Sources of further information

A benefits counselor may design the plan, and an attorney should draw up the trust agreement.

d. Considerations for the school

If claims have been amounting only to 75 per cent of premiums or less, the

school may wish to consider saving money on unused premiums by making deposits into its own trust and hiring an insurance company to assume the risk formerly borne by premium payments. The possible benefit to the school is that it would realize the possible savings between the premiums formerly paid and the claims, which in this case were only 75 per cent.

e. Considerations for the employee

The employee has the same guarantees as before. Stop-loss is not a different plan but another way of paying health insurance premiums.

f. Example of benefit in practice

The head of the school recognizes that the school has been paying more than $100,000 in health insurance premiums for employees and their dependents. Up to now, the school's experience with claims has been approximately 75 per cent of premiums, or $75,000. The head asks the school's insurance agent to negotiate with a local claims administrator and an insurance company for a stop-loss plan. An administrator is necessary because claims must be handled from the inception of the policy.

The benefits provided by the new plan are exactly the same, but the $100,000 in premiums is paid into a trust fund rather than to the insurance company. Approximately $10,000 is given to the administrator to pay claims. Another $10,000 is paid to the insurance company, which has agreed to pay claims after-- and not until-- they have reached a total of $80,000. The insurance company is willing to assume this risk because last year's claims totaled only $75,000. If claims are low, the insurance company comes out ahead, as does the school. The school also earns interest on its own account. If claims exceed $80,000 a year, the insurance company pays them.

g. Legalities and liabilities

A 501(c)(9) trust agreement must be drawn. All liabilities are determined in that agreement.

This plan is subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting, disclosure, and fiduciary responsibilities. The school should tell employees what is covered and, more important, what is not covered in the contract. The school must tell employees what options to continue coverage are open to them upon termination of employment. Otherwise, employees encountering new medical bills could claim that they had not been told about these, which in turn could make the school liable for former employees' medical bills.

h. Effect of termination of employee

The school notifies the claims administrator and the insurance company that the employee is no longer covered.

6. Disability Income Plan

a. Description of the benefit plan

A disability income program pays employees a salary if they are disabled or unable to work. Coverage usually starts after 30, 90, or 180 days of disability, and the benefit continues to be paid as long as the employee is disabled, up to age 65.

b. Type of employee entitled to benefit

Disability income policies are issued for group and individual plans. Under a group plan, all employees must be covered. Under an individual program, the school may select the recipients or even only one recipient.

c. Sources of further information

A benefits counselor may be asked to design the program. An attorney should draft the resolution incorporating the plan for the board of trustees.

d. Considerations for the school

The cost of a group disability income plan is fairly inexpensive; all employees must be covered. Although an individual plan costs more, the school may limit the number of participants in the plan. The school may also require employees to pay 50 per cent of the premium under either type of plan, thus reducing its own cost.

e. Considerations for the employee

If the school pays the premium under either type of plan, the employee has nothing to consider. If employees are required to contribute, they should measure the cost against the value of the benefit.

f. Example of benefit in practice

The head of the school suggests that the school carry a disability policy for its 100 employees. After considering the cost of the group program--about $5,000 a year--the school decides instead to implement an individual program for the head only, which will cost the school only $500 a year. The plan is developed as follows.

If the head is disabled for at least six months, the insurance company will pay her $1,500 a month (50 per cent of her monthly salary). She will receive this payment until she is no longer disabled or until she is 65. This income is taxable. The premiums paid by the school are not considered to be current, taxable income to the employee.

g. Legalities and liabilities

The board of trustees should prepare a resolution that incorporates the plan. Most insurance companies have a sample resolution, which needs to be approved by the school's attorney before being adopted.

The plan is subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting, disclosure, and fiduciary responsibilities.

h. Effect of termination of employee

If the school has a group plan, the employee's name is eliminated from the group contract and the premium is adjusted accordingly. No conversion to an individual policy is available. If the policy is an individual one, the employee is given the policy and may decide whether or not to maintain coverage.

7. Group Life Insurance Plan

a. Description of the benefit plan

Under a typical group term life insurance plan, as distinct from the type that builds cash values, one or more levels of coverage (death proceeds) are offered among all employees or certain categories of employees. The net cost to employees is usually much lower than what they would pay individually. Term insurance, pure protection coverage, provides a great deal of protection for a small amount of money in the early years.

b. Type of employee entitled to benefit

The school may select one or more categories of employees to receive this benefit. Eligibility and amounts of coverage must conform to certain formulas, described below.

c. Sources of further information

A benefits counselor may be asked to design the plan in accordance with a formula of the type shown below.

d. Considerations for the school

This plan offers no disadvantages to the school other than the additional cost of providing coverage. Premium costs may go up as the ages of employees increase.

If the school has fewer than 10 employees in its regular group plan, coverage under individual "group" insurance must meet certain minimum and maximum levels, and all full-time employees must be covered. An individual "group" policy is a plan in which a single employee or small group of selected employees purchases a

term policy or policies on an individual basis. The master group policy is amended to include these individually purchased policies. With reference to the example below, Type 1 employees may not receive more than two and a half times the coverage that Type 2 employees receive, Type 2 employees may not receive more than two and a half times what Type 3 employees receive, and so on. In addition, the maximum coverage may not be more than 10 times the minimum coverage.

If 10 or more employees are in the group plan, designated categories of employees may receive any reasonable amount of coverage. The following schedule would be acceptable.

Type 1	Senior administrators	$100,000
Type 2	Department heads	$50,000
Type 3	Teachers	$10,000
Type 4	All others	$5,000

With 10 or more employees covered, the school may choose one or several categories of employees to receive these increased benefits. A senior administrator, for example, who has had $50,000 of coverage in the regular group program applies for an additional $50,000, and the plan is amended to accommodate the new category.

e. Considerations for the employee

The school can probably provide coverage for its employees for less money than they could by themselves, thus saving them the cost of the premium, which is not tax-deductible. There is, however, a small tax liability for the individual participant in group life insurance whose coverage exceeds $50,000 because the Internal Revenue Service considers this a taxable benefit. In addition, if the plan discriminates in favor of "key employees," as defined in the Internal Revenue Code, these employees are taxed on the first $50,000 of coverage as well.

f. Example of benefit in practice

Several employees of the school have individual term life insurance policies and pay their premiums with after-tax dollars. The school decides to provide all employees who have at least three months of service with $10,000 of group term life insurance coverage.

An art teacher currently carries $40,000 of personal term life insurance for which he pays $60 a year. His premium is not tax-deductible. If the school were to adopt a group life plan designed to benefit several categories of employees and the $50,000 coverage was within the acceptable limit for this teacher, the cost of the identical $50,000 would probably be lower under the group plan than the $60 the teacher is now paying for $40,000 worth of coverage. The teacher would also no longer be taxed on that cost.

If the school were to adopt a plan that provided greater coverage for certain categories of employees, such as those outlined above, and if any "officers" of the school, as defined by the IRS, benefited from the greater coverage, these officers would be subject to tax on the imputed value of the coverage, including the first $50,000.

g. Legalities and liabilities

Group life insurance policies are subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting, disclosure, and fiduciary responsibilities.

h. Effect of termination of employee

Upon termination, the employee simply assumes payment of the premium to the insurance company on an individual term basis. The school has no further responsibility to continue the premium payment on this policy.

8. Travel Accident Insurance Plan

a. Description of the benefit plan

A travel accident plan is a life insurance policy that provides a death benefit on behalf of an employee traveling on school business. The policy can be extended to include travel on personal business at little additional cost.

b. Type of employee entitled to benefit

Because a travel accident policy is so inexpensive, many schools include all employees. The school may, however, select a single employee to receive this coverage.

c. Sources of further information

A benefits counselor may be asked to design the plan.

d. Considerations for the school

A school's greatest concern should be for employees who travel a great deal. The school may designate different amounts of coverage for different employees.

e. Considerations for the employee

On the assumption that the school pays the entire premium, the employee has little tax liability or out-of-pocket expense.

f. Example of benefit in practice

The school, recognizing that certain employees travel a great deal on its behalf, decides to provide additional protection for their families over and above basic group life insurance and other benefits. The school's benefits counselor designs a program that will provide $100,000 of 24-hour protection for the head and $50,000 for other employees. The program is set up so that the $100,000 covers the head on business at a cost of $100 a year, and the $50,000 covers other employees at a cost of $50 per employee per year.

g. Legalities and liabilities

Other than being obliged to make timely premium payments, there is usually no liability to the school. In some cases, this arrangement might be considered an "employee plan," whereby the school would be subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting, disclosure, and fiduciary responsibilities. The death benefit is paid by the insurance company directly to the employee's beneficiary.

h. Effect of termination of employee

The school stops paying premiums when an employee terminates. The school may require a partial refund from the employee upon termination.

9. Prepaid Group Legal Plan

a. Description of the benefit plan

Under a group legal plan, the school may sponsor, directly or through insurance, legal consultation for employees. Premium contributions and the value of legal services received will not be counted as employee income if the plan meets the nondiscrimination and other requirements of the Internal Revenue Code.

b. Type of employee entitled to benefit

All employees must be covered, no matter whether this benefit is financed through insurance or through the school.

c. Sources of further information

If an insurance contract is to be used, a benefits counselor may be consulted. If the school retains a legal firm, the firm should be consulted.

d. Considerations for the school

An insured plan uses a list of participating attorneys, all of whom have agreed to accept specific fees as payment for services. This is called an "open panel." Coverage usually includes drafting wills and trusts and routine legal advice.

An alternative is for the school to retain one firm. This arrangement is known as a "closed panel." Usually the program includes only consulting advice. The advantage is that the attorney selected could be at the school one day each week, if needed. The cost of the plan is negotiated directly with the firm; insurance premiums, on the other hand, are usually not negotiable.

e. Considerations for the employee

Employees ordinarily are not required to pay anything, nor do they have a voice in designing the program. As potential recipients of the program's benefits, however, employee/clients should consider the competence of the attorney selected by the school.

f. Example of benefit in practice

A school undertakes a sponsored (uninsured) prepaid group legal program. A firm specializing in the general practice of law stations a senior associate attorney at the school one and a half hours each week, or six hours a month. The cost, at $50 an hour, or $300 a month, is less than the cost of the insured plan the school investigated.

The head has a specific problem that he believes may make him subject to a lawsuit. He calls the attorney and meets with her during the specified time she is at the school. After some discussion, the attorney says she believes the head is blameless and writes the appropriate letter to the other party. There is no charge for this consultation or for the single letter. If a suit should occur, the head may retain this lawyer or someone else.

g. Legalities and liabilities

In the retainer, the law firm should describe precisely the services to be provided and note services that incur extra charges.

The plan is subject to ERISA (Employee Retirement Income and Security Act of 1974) reporting, disclosure, and fiduciary responsibilities.

h. Effect of termination of employee

Terminated employees are no longer able to consult the attorney free of charge.

10. Financial Counseling

a. Description of the benefit plan

This benefit is an employer-sponsored consulting service to allow designated employees to tailor the school's various employee benefits to their own financial needs and goals.

b. Type of employee entitled to benefit

Financial counseling is not a group insurance benefit. The school may designate any employee to receive it.

c. Sources of further information

Financial counseling often uses the team approach. A counseling team may include an attorney, benefits counselor, stockbroker, certified public accountant, or trust officer.

d. Considerations for the school

The school should select those employees who can best use the services of its advisers and measure the cost of this new benefit against its value. The primary consideration for the school is the selection of advisers it wishes to sponsor and their negotiated fees.

e. Considerations for the employee

Participating employees need to present an inventory of their assets to the advisers and be prepared to define their short-, intermediate-, and long-range goals. The fees paid by the school could be construed as additional taxable income to the employee.

f. Example of benefit in practice

A teacher and several other senior employees at the school have spouses working elsewhere. They are concerned about their financial situations. The teacher has extensive stockholdings and some real estate. Her husband has a small inheritance that is invested in oil stocks. Their concern is current income, intermediate cash needs--their children's education--and long-range retirement needs 15 years from now. A financial counseling team is made available and paid for by the school. The counseling team asks the teacher to supply detailed financial information. After several meetings with the teacher, it is determined that she should sell her non-income-producing stock, refinance her real estate, and participate in other tax-favored plans the school offers its employees.

g. Legalities and liabilities

The school should specify that its sponsorship of financial counseling involves it only to the extent of paying for this benefit. The school should make a point of not being involved in or liable for any decision concerning the purchase or sale of any security or real or personal property.

h. Effect of termination of employee

The terminated employee is no longer entitled to meet the financial consulting team free of charge.

INDIRECT PAY PLANS

Indirect pay plans are designed to improve the quality of life of the school's employees. Unlike plans that allow for accumulation of capital or provide financial protection, indirect pay plans provide special privileges that may be offered to a few employees or all employees. Some of these programs, such as use of the school's tennis courts, are easy to administer and cost the school only a modest amount.

The common denominator of indirect pay plans is that the expense of a benefit may take the form of reimbursement to the employee rather than payment of a premium to an insurance company or other commercial organization.

1. Professional Memberships

a. Description of the benefit plan

The school pays for or reimburses the employee for dues for membership in professional organizations, which may include eating clubs or other groups where school business is discussed.

b. Type of employee entitled to benefit

This program may be offered to a single employee or a group, such as all teachers, coaches, or administrators.

c. Sources of further information

An attorney or benefits counselor may be asked to draw up the guidelines applying to this benefit.

d. Considerations for the school

The school should decide who the recipients of this benefit will be, the limit of reimbursement or direct payment by the school, and what types of organizations are acceptable.

e. Considerations for the employee

The use of this benefit is limited to business. If it is used for other purposes, reimbursement for dues is treated as current income subject to tax.

f. Example of benefit in practice

The head of the school occasionally meets with board members away from the school. The best place to meet is at a club rather than at a busy restaurant. A new business luncheon club has recently opened near the school. The head asks the board to have the school pay the initiation fee of $400 and the annual dues of $500. The school agrees to do so but, recognizing that the head will probably use the club for personal reasons at least 20 per cent of the time, says that it will report 20 per cent, or $100, of the $500 dues as personal income. The cost to the head is therefore only the tax on $100 for being a member of this club.

g. Legalities and liabilities

None. The school should, however, stress its purpose in sponsoring professional memberships.

h. Effect of termination of employee

The school no longer pays the employee's membership fees.

2. Tuition Payment Plan

a. Description of the benefit plan

Under this plan, the school allows free or reduced tuition for employees' children.

b. Type of employee entitled to benefit

The school may be selective in providing this benefit, but objective criteria, such as years of service and per cent of benefits, must be determined. This benefit must be available to all eligible employees.

c. Sources of further information

An attorney should be asked to study the document that provides this benefit.

d. Considerations for the school

The school may design a full or partial tuition plan, depending on an employees' length of service with the school. The school could, for example, allow all employees having children in the school to receive a base reduction in tuition of 50 per cent, with increments of 10 per cent for each year of service after five years, up to a stated maximum. No discrimination may be made among employees who have served a given length of time.

e. Considerations for the employee

Employees who have school-age children may give them an independent school education at reduced cost.

f. Example of benefit in practice

A teacher is applying to work as principal of the middle school. She is offered a similar position in a nearby public school at a salary of $2,000 more. She has three children in the independent school, at a cost of $7,800. This amount would be halved, because she would receive a 50 per cent reduction in their tuition. She decides to accept the position at the independent school.

g. Legalities and liabilities

There is no liability to the school in granting discounts on tuition to its employees on a discriminatory basis. The Internal Revenue Service, based on the Deficit Reduction Act of 1984, should not impute income up to the value of the reduced tuition to the employee.

h. Effect of termination of employee

The school might charge the terminating employee the same portion of tuition it would normally charge other parents for the period of time the employee's child is in school after the termination.

Note. NAIS issued the following memoranda on tuition remission between 1972 and 1981.

"Tax Treatment of Tuition Remission," August 11, 1972.
"Revision Expected by IRS on Tuition Remission Programs," February 21, 1973.
"Proposed IRS Revision on Tuition Remission," November 16, 1977.
"Tuition Remission: IRS Proposed Regulation," January 19, 1977.
"Taxation of Tuition Remission," March and April, 1981.

3. Dining Hall Privileges

a. Description of the benefit plan

The school underwrites free or greatly reduced meal charges for employees.

b. Type of employee entitled to benefit

The school should not restrict this benefit to certain employees.

c. Sources of further information

The school's business officer should be asked to provide average costs for meals.

d. Considerations for the school

After ascertaining this cost, the school should decide to what degree it wishes to subsidize meals.

e. Considerations for the employee

The only consideration for employees is whether or not they wish to eat at the school.

f. Example of benefit in practice

The school, having ascertained that lunch, including utilities, costs an average of $1.00, offers a 50 per cent subsidy as an incentive for teachers to stay on campus at noontime.

g. Legalities and liabilities

The value of this benefit is not counted as income if it is furnished on the school's premises for the convenience of the school.

h. Effect of termination of employee

A terminated employee may not eat at the school at reduced rates.

4. Automobile Leasing Plan

a. Description of the benefit plan

Under this plan, the school reimburses certain employees for leasing automobiles in their own name.

b. Type of employee entitled to benefit

This benefit is usually limited to the head, coach, business manager, admission officer, or any other employee whose work involves extensive use of a car for school business.

c. Sources of further information

An attorney should draft the resolution authorizing this benefit.

d. Considerations for the school

If the school owns an automobile and lends it to an employee, the school usually finds itself in the position of having a used car with high mileage when the employee leaves. A new employee may be reluctant to accept this older automobile as part of an employee benefit package, in which case the school must provide another automobile. Allowing employees to lease their own cars gives them cars they choose and makes them responsible for the lease.

e. Considerations for the employee

If employees are permitted personal use of automobiles, reimbursement for the portion of the cost of the lease that is attributable to personal use of the car is considered to be income for tax purposes. An employee who leaves might be liable for lease payments not reimbursable by the school.

f. Example of benefit in practice

The head of the school is promised the use of a car as part of his contract. The school decides that the car will be leased. The head leases the car in his name for $250 a month. The head is asked to provide the school with a breakdown of personal and business use of the car. The school reimburses him each month and reports 20 per cent of the cost of the lease as taxable compensation because he is making personal use of the car 20 per cent of the time. The cost to the head is the income tax he must pay on this $50 per month.

g. Legalities and liabilities

The only liability to the school is to reimburse the employee according to the agreement. The employee is responsible for the lease.

h. Effect of termination of employee

An employee who leaves must continue to pay the lease. The school is free to initiate a similar arrangement with a new employee.

5. Housing

a. Description of the benefit plan

Many schools provide free or subsidized housing for some or all of their full-time employees. Boarding schools might provide this as incentive to work during

"nonbusiness" hours. More and more schools are allowing their heads to buy a house at a figure determined through appraisal, with the proviso that the school has the first option to buy the house back when the head leaves.

b. Type of employee entitled to benefit

The school may offer free or reduced-rate housing to all full-time employees on an "availability" basis. The school should probably limit the purchase program to the head or other senior staff members.

c. Sources of further information

An attorney and a real estate appraiser should be consulted before entering a purchase arrangement.

d. Considerations for the school

The school should offer housing to employees who are present for after-school activities.

e. Considerations for the employee

Subsidized or free housing is helpful, but employees build up no equity by availing themselves of this option.

f. Example of benefit in practice

A head who has a husband and children, about to enter into a contract with the school, is offered free use of a house. The head does not like this arrangement because she has come from a school that also provided her with free housing; after 15 years there, she and her husband had no equity in the house. To meet the head's concern, the school retains an appraiser, who, with a second appraiser employed by the head, determines that the house is worth $100,000. The head buys the house from the school, paying about $20,000 in cash, which the school could lend her at a low rate of interest. The head secures a conventional mortgage for the remaining $80,000 through a bank.

The head decides to leave the school after 10 years of service. She retains an appraiser, who, with the school's appraiser, determines the value of the house to be $150,000. The head has reduced her mortgage from $80,000 to $60,000. The school exercises its option to buy the house for $150,000. Paying off the remaining $60,000 of her mortgage and the $20,000 loan from the school leaves the head with $70,000 equity.

g. Legalities and liabilities

The school should realize that, if it grants an interest-free loan to the head to help buy a house, its endowment fund is reduced by the amount of the loan for

the duration of the loan. Any loan made to an employee, on a demand basis, is only as secure as the employee's capacity to repay it. The school can arrange to maintain some interest in a house if the head does not make timely payments to the bank. This plan should be developed in a separate agreement with the head. The head should realize that, if the value of the house declines, the loss is the head's, not the school's.

h. Effect of termination of employee

When the head leaves the school, he or she must give the school the first option to buy back the house and must repay any interest-free loan.

6. Sabbatical Leave

a. Description of the benefit plan

A sabbatical leave policy allows employees who have served the school for a certain amount of time to leave the school at full or partial pay to continue studies in their respective academic disciplines.

b. Type of employee entitled to benefit

This benefit is usually limited to the head of the school, admininstrators, and faculty members who have served for a specific period of time, commonly seven years. Full pay is commonly offered if the recipient is away for one semester, half pay for the entire year.

c. Sources of further information

An attorney should draft the sabbatical leave agreement.

d. Considerations for the school

The school should consider which employees are eligible and what length of time should constitute sabbatical leave.

e. Considerations for the employee

Employees should consider what type of work they wish to pursue during sabbatical leave.

f. Example of benefit in practice

A sociology teacher who has been at the school for seven years wishes to travel to the Amazon to study tribes as part of the research for a book she is writing.

The school plans to pay her full salary for the six months she will be away. The school also requires her to develop a new course based on her sabbatical studies to be offered the following year.

g. Legalities and liabilities

The school has no liabilities. The teacher must develop the new course as agreed.

h. Effect of termination of employee

Sabbatical leave is usually granted only after a teacher has been employed for a certain period at the school. Termination of employment before this time automatically negates the possibility of sabbatical leave.

CAFETERIA COMPENSATION PLANS

Many institutions and organizations, recognizing that employee benefit costs are climbing and that family patterns are changing, have instituted flexible compensation programs to try to keep in step with these changes. Cafeteria plans, which allow employees, within limits stated by the law, to design benefit programs that meet their own particular needs, are becoming more more and more widely used.

The Deficit Reduction Act of 1984, signed into law in July 1984, has resolved many issues that surrounded cafeteria plans during the time this legislation was being formulated. The following summary of cafeteria plans and the new law comes from an NAIS memorandum about the Deficit Reduction Act sent to member schools in September 1984.

* * * * *

The Deficit Reduction Act of 1984 contains both good and bad news for school benefit plans. The good news is that the confusion and legal limbo in which cafeteria plans have developed over the past few years has finally ended with government approval of salary reduction as a funding mechanism for cafeteria plans. Schools that have proceeded cautiously and uneasily into this new ground or have stood on the sidelines waiting clarification of the rules may now proceed with confidence. The bad news is that most current school cafeteria plans set up under IRS Section 125 will need to be amended not later than December 31 to bring them into compliance with the new rules.

The following review of the Deficit Reduction Act has been compiled from several sources but is primarily adapted from an analysis provided by William M. Mercer-Meidinger, Inc., benefits counselors, and used with permission. This review, not exhaustive and in some cases oversimplifying fairly complex rules, is intended as a guide to suggest potential problems for schools that may require more careful study and professional counsel. School heads and business officers are advised to review their benefit plans with their accountant and attorney and to take any corrective action necessary to bring their plans into compliance with these new rules and regulations.

Typical cafeteria plans offer employees a choice between cash or additional benefits beyond a minimal core, combined with a salary reduction agreement, which shifts the cost of the plan to the employer to reduce taxable income to the employee. While cafeteria plans have been permitted since the Revenue Act of 1978, until recently the Treasury Department did not provide any specific guidance or regulations governing what could and could not be done in designing cafeteria plans.

Since 1978 increasingly creative approaches to cafeteria plans have evolved, including flexible spending accounts, benefit banks, and zero balance reimbursement accounts (ZEBRA's). While these plans vary in their details and sophistication, all involve conversion of taxable employee

income to nontaxable employer payments for an ever-increasing array of benefits. Some plans include an individual benefit account out of which benefits are paid (including reimbursement of medical and dental expenses that are not covered under regular programs), with "cash-out" provisions, under which money remaining in the account at the end of the plan year is returned to the employee as taxable cash.

Confusion over the status of cafeteria plans accelerated when the Internal Revenue Service unexpectedly issued a news release on February 10, 1984, declaring that most existing flexible spending arrangements would not qualify under Section 125. The IRS based its position on Section 105 of the Internal Revenue Code, arguing that this section required an element of risk regarding amounts contributed to a medical reimbursement account. That is, once the contribution has been made to the account, it must be used for eligible expenses during the period of coverage or be forfeited. Further, the IRS declared that this position would be applied retroactively to any Section 125 program from its beginning.

This sudden move by the IRS led to strong protest from the field, primarily because employers had received no IRS notice during the six year period that such plans were evolving and felt it was unfair for the IRS to make rules retroactive that penalized plans set up in good faith. Consequently, on May 4, 1984, in response to this widespread unhappiness, the Treasury Department issued proposed regulations for Section 125 cafeteria plans in the form of "questions and answers." Shortly after the release of these proposed regulations, Congress passed the Tax Reduction Act of 1984. Based upon the proposed regulations and the relevant provisions of the act, the following composite picture of acceptable Section 125 plans has emerged.

- Cafeteria plans are restricted to choices between cash and certain nontaxable benefits specifically permitted by separate sections of the Internal Revenue Code: life insurance (Section 79), medical plans (Sections 105 and 106), legal services (Section 120), and dependent care (Section 129).

- Dependent life insurance and group term life insurance in excess of $50,000 may be included, even though they are taxable. Vacation days also are treated as nontaxable benefits, provided that the vacation policy does not permit cash-outs or carryovers beyond the end of the plan year.

- Salary reduction is permitted as a method of funding cafeteria plans.

- Advance election must be made by employees before the beginning of the plan year. This election is irrevocable, except in cases of changed family status or changes in spouse's employment.

- Separate elections must be made for each type of benefit (such as health care, dependent care, legal services).

- Once the election is made, the amount directed to a given benefit must be used only for that benefit and must cover expenses incurred

during the plan year. No cash-outs, rollovers, or carryovers are permitted.

- Effective January 1, 1985, no more than 25 per cent of the total nontaxable benefits provided under the cafeteria plan may be provided to key employees. The cafeteria plan must cover all employees that does not discriminate in favor of highly compensated employees. If highly compensated employees utilize select nontaxable benefit options under a cafeteria plan to a greater extent than other participants, the highly compensated participants will be taxed on those otherwise nontaxable benefits.

- For tax years that begin after December 31, 1984, employers must file a return that shows the total number of employees, the number of employees who participate in the cafeteria plan, the total cost of the plan, and employer identification information.

- A general transition rule provides relief from application of the proposed regulations until January 1, 1985, for cafeteria plans and flexible spending arrangements (including benefit banks and ZEBRA's) that were in existence February 10, 1984, or for which substantial implementation costs had been incurred as of that date.

- A special transitional rule provides relief until July 1, 1985, for cafeteria plans that provide cash-outs, rollovers, or carryovers if they are amended to provide for advance election before the beginning of the benefit coverage period and provide for cash-outs, rollovers, or carryovers that are not available until the end of the benefit coverage period or termination of employment.

- Exception. These transitional rules do not apply to a cafeteria plan or flexible spending account if the plan was modified after February 10, 1984, to provide additional benefits. If a modificaon was made, the transitional relief ends on its effective date. This particular rule has the apparent effect of penalizing employers who tried to comply with the February 10 IRS statement. The Treasury Department is now reconsidering this issue and may modify the transitional rules.